



Report for Quarter Ending November 30, 2003

**TO:** United States of America Agency for International Development  
Contract # 168-C-00-03-00101-00, March 1, 2003 to August 31, 2004  
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## Brief Comments on Banking Sector

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The banking sector continues to experience dramatic change. Confidence in banking has increased as indicated by the steady increase in deposits. As the banking sector was being cleansed of the worst banks, well-known foreign banks entered and now dominate the market. Concentration is continuing with four banking companies holding 66% of total deposits. They are making rapid changes in banking and bringing new services and products. These banks substantially increased lending to citizens and small businesses.

The number of banks declined from its peak of 73 at YE-1998 to 37 as the worst banks were removed and progressive strengthening of standards encouraged consolidation. That number will shrink further in coming months under the pressure of meeting the criteria for deposit insurance, privatization, prudent banking standards and increasing competition.

Nineteen banks are in the deposit insurance program. Banks that did not qualify by the August 12, 2003 deadline were required to develop plans by November 30, 2003 for meeting the requirements. A few banks will be unable to meet the requirements and will be intervened.

Six banks that have not met the deposit insurance requirements belong to the Federation government, including four under Provisional Administration. Officials are trying to develop a consolidation plan for these six banks. A new law is being drafted to enable this action. The thought is that the consolidated bank would be more attractive to strategic investors in privatization than the present small banks. However, the six banks collectively have less than 3% of total BiH deposits but 9% of the staff.

The following numbers reflect the continuing strong growth in deposits and loans.

Bosnia and Herzegovina Banking System				KM millions		
	YE-1999	YE-2000	YE-2001	YE-2002	6/30/03	12/20/03
Total Deposits	1,838	2,094	3,323	4,158	4,598	5,393
Total Loans	1,455	1,652	2,104	3,214	3,655	NA

## USAID Bank Supervision Project

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### Contract Objectives:

The overall objective of this contract is to further develop the supervisory capacity and supervisory culture of well-respected professional supervisors who are empowered to carry out their duties and responsibilities as required by their banking laws. A critical decision, that's still subject to on-going discussions, is the merger of both the RS and Federation banking agencies into one integrated state agency under the umbrella of the Central Bank. The final resolution of this issue will affect the delivery mechanism of some tasks within this task order.

### **The Specific Objectives of this contract are to:**

- 1) Facilitate the legal, operational, political and financial transition of both the RS and Federation Bank Supervision Agencies, to the greatest extent possible, into one integrated agency as part of the Central Bank to ensure long-term independence and sustainability;
- 2) Strengthen the operational capacity of the agencies, which includes management capacity, training and staffing development as well as financial sustainability as the sector changes;
- 3) Implement the recommendations of the anti-money laundering working group and assist the agency in combating money laundering as the sector and agency evolve;
- 4) Assist the local authorities in the resolution of problem banks, and develop the capacity of the Deposit Insurance Agency to address the resolution of problem banks. (The wording in Italics was changed to: *“and develop the capacity to perform payouts on insurance events and to ensure recovery of funds during the bank resolution process.”*)

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#### Tasks and Accomplishments:

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- VI. Problem Banks
- VII. Anti-Money Laundering and Combating the Financing of Terrorism

## Statement of Work: Summary of Accomplishments

### I. INSTITUTIONAL DEVELOPMENT

I-a. Facilitate the consolidation of bank supervision into the CBBH or an independent state level agency. \* > Ongoing effort

Met	Partial	Not Met
	X	

Political resistance has delayed the consolidation of bank supervision.

The development of the common database is progressing and on plan.

Bank regulatory reports are essentially completed and harmonized.

I-b. Improved communication amongst staff within the banking agencies and with the Central Bank.

Met	Partial	Not Met
	X	

I-c. Develop supervisory tools through policies, procedures and training to ensure more effective supervision of banks and their subsidiaries/affiliates.

Met	Partial	Not Met
	X	

Significant efforts made, including recommendations for enhancing laws.

I-d. Strengthen the supervisory capacity of senior management and field supervisors to provide for a safe and sound financial sector in Bosnia by anticipating challenges, especially in new markets, products and risk areas.

Met	Partial	Not Met
	X	

Largely accomplished on the training aspect.

None on Human Resources and Examiner Accreditation.

I-e. Develop an improved 'early warning' capability that better integrates various indicators of a bank's condition so that the banking agency can address potential issues earlier.

Met	Partial	Not Met
		X

No measurable achievement, but see progress on common database on which the improved software is planned to operate.

I-f. *Expand the banking agencies abilities to other related financial sectors. Three such sectors are insurance, investment banking and investment or money management funds. As banks expand into other lines of business, the banking agencies will need to keep abreast of these developments, and to build up in-house expertise to identify the kinds of risks that these lines of business can cause depositors.*

Met	<b>Partial</b>	Not Met
	<b>X</b>	

I-g. *Develop supervisory capacity to recognize and identify the inherent risk (capital, asset quality, earnings, liquidity, risk management and internal controls) at the consolidated level, as well as individual subsidiaries and/or affiliates level.*

Met	<b>Partial</b>	Not Met
	<b>X</b>	

## II. REGULATIONS

*Recommend regulatory changes to facilitate improved bank supervision. As supervisory activities expand, current regulations will need to be revised and enhanced, and new regulations created to incorporate the necessary components for an effective and efficient legal, regulatory and judicial framework.*

Met	<b>Partial</b>	Not Met
	<b>X</b>	

## III. LEGAL FRAMEWORK

III-a. *Improve the legal protection for bank agency staff (management and supervisors) so they are not at risk of personal liability when carrying out their official functions.*

Met	<b>Partial</b>	Not Met
	<b>X</b>	

III-b. *Influence the courts to demonstrate appropriate judicial deference to the expertise of the banking supervisor as is common in most western economies.*

Met	<b>Partial</b>	Not Met
	<b>X</b>	

**IV. INTEGRATED SUPERVISION**

IV-a. Encourage and facilitate cooperation and integration of functions, to the greatest extent possible, between the RS and Federation banking agencies.

IV-b. Work with the Central Bank to better integrate the bank supervision functions between both entities, possibly creating one combined agency at the state level.

Met	<b>Partial</b>	Not Met
	<b>X</b>	

See also, I-a. Consolidation of bank supervision.

**V. DEPOSIT INSURANCE**

V-a. Encourage and facilitate cooperation between the bank supervision agencies and the BiH Deposit Insurance Agency.

Met	<b>Partial</b>	Not Met
	<b>X</b>	

V-b. Strengthen the links and capacities of the Bank Supervision Agencies, the Central Bank and the Deposit Insurance Agency. Ultimately, this may lead to the integration of all or some of these functions into one unit.

Met	<b>Partial</b>	Not Met
	<b>X</b>	

V-c. Strengthen the capacity of the Deposit Insurance Agency to protect the Insurance Fund and ensure the maximum recovery of funds paid out for insured deposits.

Met	<b>Partial</b>	Not Met
	<b>X</b>	

**VI. PROBLEM BANKS**

VI-A. Facilitate the timely and effective resolution/liquidation of problem institutions, particularly ones taken over by the banking agencies.

<b>Met</b>	Partial	Not Met
<b>X</b>		

Largely met in FBA, partial in BA-RS.

*VI-b. Ongoing refinement of the legal/regulatory framework to ensure the banking agencies and Deposit Insurance Agency have appropriate authority in problem bank resolution and liquidation.*

Met	<b>Partial</b>	Not Met
	<b>X</b>	

**Largely accomplished.**

## **VII. ANTI-MONEY LAUNDERING and COMBATING THE FINANCING OF TERRORISM**

*Implement the recommendations of the anti-money laundering working group and assist the agency in combating money laundering as the sector and agency evolve.*

Met	<b>Partial</b>	Not Met
	<b>X</b>	

**Substantial efforts and progress made.**



## Statement of Work: Tasks and Accomplishments

This task order will continue in many areas of the prior contract with particular emphasis in the following areas with **SOW Headings in Bold CAPS**:

(Notes:

- *Contract SOW omitted two items from Objectives that have been **inserted**: i.e., “I-a: Consolidation” & “VII: Anti-Money Laundering and CFT”.*
- ***Measurable Goals** are listed at the end of each listing of work.*
- ***Achievements** follow **Measurable Goals**.*
- ***BSP = Bank Supervision Project***)

### **I. INSTITUTIONAL DEVELOPMENT**

**I-a. Facilitate the consolidation of bank supervision into the CBBH or an independent state level agency. \* > Ongoing effort**

- 1) Participate in working groups to achieve consolidation into an effective, independent and sustainable unit.
- 2) Initiate actions in support of this objective.
- 3) Work with others on legal changes to Laws on CBBH, Banks and Banking Agencies. Bring expert attorney to develop draft of legal framework in conjunction with others.
- 4) Actively participate with others on Organizational Changes needed to accomplish objectives.
- 5) Provide TDY to assist with Human Resources issues, including Change Management, and a re-start of efforts on Examiner Accreditation, Performance Evaluation, etc.
- 6) Provide Expert on IT, Consolidation Database and software to upgrade usability of data for analysis.

### **Measurable Goals:**

- Two banking agencies will be consolidated and operating as one with two locations (*requires multi-party agreement and commitment*).
- Laws and Organizational Changes will be substantially accomplished.
- Human Resource initiatives on Examiner Accreditation and Performance Evaluation will be in operation.
- Consolidated database and upgraded software will be in operation for FBA, BA-RS, DIA and CBBH.
- Plans will be initiated to streamline the reporting process.

**Level of Achievement.****Consolidating Bank Supervision Agencies:**

No measurable achievement at this point due to political opposition to movement of entity government bodies or agencies to state level. However a number of actions have been taken towards this objective:

- There have been several discussions on the merits of bank supervision consolidation and possible structural organizations. The proposal advanced by the CBBH Governor is to consolidate bank supervision under the Central Bank functionally separated from other departments of CBBH. The Director of Bank Supervision would report to the Governor who would Chair a separate Managing Committee of the Board focused on bank supervision.

Another proposal is to form a state level entity with a connection to the CBBH for certain policy and oversight issues. One option is to include the Governor, a Vice-Governor and one appointee from each entity MOF and the Ministry of Treasury (state level) on the Managing Board (i.e., like Deposit Insurance Agency). One objective of this proposal would be to keep supervision officials and staff focused on supervision issues. It would also position the agency for the potential future integration of non-bank financial supervision (e.g., micro-finance organizations, financial-leasing companies, insurance, etc.).

Branches would be maintained in Banja Luka and Sarajevo in general proportion to the work needs in either proposal.

- August 14, 2003: BSP Advisor Wilson and Associate Tuzovic met with Governor Peter Nicholl to discuss Consolidation, Legal Protection, Common Database and other issues. He agreed to initiate action on Consolidation in the near future. However, Mr. Nicholl indicated concern for needed legal protection in practice as well as law and said he would meet with an official of OHR to discuss this concern before moving forward on consolidating bank supervision under the Central Bank. He agreed with our plan to bring an attorney in October to make recommendations on legal changes in these areas.
- September 15, 2003: BSP Advisors Wilson and Taber, Associate Tuzovic, USAID CTO Meyer and Associate Zivojnovic met with CBBH Governor Nicholl to reinforce the cooperation and support for these efforts. He stated that he was preparing a proposal to present to his Managing Board.
- Governor Nicholl presented his proposal on October 9th. An objection was raised based on the need for an agreement by the RS Prime Minister before proceeding. This was political opposition to moving government bodies from entity to state level.  
RESULT: Initiative delayed until after holidays, i.e., February 2004.

**Others' Actions in Support of this Initiative in November-December 2003:**

- Governor Nicholl brought Professor Goodhart to Sarajevo for a brief presentation on the structural location of bank supervision. He is well known for expertise on bank supervision issues.
- Vice-Governor Kozaric wrote an article on why bank supervision should be in the Central Bank.

- Governor Nicholl discussed the issue at the Bank Supervision Coordination Meeting. He noted that most government officials generally agreed with the proposal but a few thought resistance was building in some areas due to other major initiatives involving the entities losing authority to state. Governor Nicholl said he would press again after the Holidays.
- The Directors of the two banking agencies attended a World Bank Seminar on “Aligning Bank Supervision Structure”.

### **Common Bank Report Database for Shared-Use:**

#### **Good Progress and Agreed Action Plan:**

- July-August 2003: Project advisors participated in brief diagnostics of the four IT systems in use at the two banking agencies, deposit insurance and Central Bank. This was performed to provide a base of information for the FSVC volunteers expected in October to perform an in-depth analysis and design for a common database to be implemented by World Learning.
- October 2003: BSP employed the local IT Specialist performing the initial diagnostics as an advisor to assist in the database consolidation. Senior Project Associate Tuzovic is coordinating these efforts.
- November 2003: FSVC volunteers presented recommendations for developing the common database. These were accepted by the banking agencies. One FSVC volunteer remained for one week to assist in developing plans to go forward. Interim efforts have been on working out details on the Action Plan and potential obstacles. BSP is translating the Final Report to ensure full understanding by Agency officials.
- A Project Control Committee has been named and is expected to begin functioning in January. BSP is working with World Learning and USAID to obtain Project Control training for members of the Committee (and a few others that will be involved in the Agency Consolidation noted above).
- BSP contacted USAID-DC about bank analysis software developed by USAID contract that is believed suitable for needs here. They suggested a conference call for further discussion. This will be pursued in late January.

### **Bank Report Review:**

- June 2003: Advisor Mohler outlined plans for modification of some bank reporting formats for IT, harmonization or conformity with international accounting standards (IAS). The two Offsite Departments agreed to begin reviewing and harmonizing the bank reports with a goal of completing before Ms. Mohler’s return in September.
- October 2003: The report review and harmonization was mostly accomplished with only a few issues unresolved due to differences in accounting/reporting standards of local law.

***I-b. Improved communication amongst staff within the banking agencies and with the Central Bank.***

- 1) Active participation in bank supervision coordination meetings.

>Ongoing effort.

- 2) Encourage the establishment of more specific avenues of communication and reporting beyond present coordination meetings.  
>Ongoing effort.
- 3) Invite CBBH representatives related to banking and coordination of bank supervision to training for bank supervision agencies (e.g., Overall Conclusions and Bank Ratings in June-03).  
>June-03 and Ongoing.

### **Measurable Goals:**

- Plans will be initiated to develop an internal communication process for policies, procedures and other issues that is numbered and tracked. Initially, this may be paper-based but the goal will be to use the website or electronic network.

### **Achievement:**

- May 2003: Project Advisors attended the Bank Supervision Coordination Meeting on May 22<sup>nd</sup>. Consolidation of bank supervision was one of the agenda topics. Several participants indicated a need to study the possibilities and reach a decision on the structural location and needed legal changes.
- June 2003: CBBH representatives were invited to participate in the June 6<sup>th</sup> Training Workshop but had prior commitments.
- July 2003: Project Advisors participated in a Coordination Meeting July 9<sup>th</sup>. Key topics included: Consolidation of bank supervision, money laundering issues, foreign exchange and reserve requirement changes, deposit insurance, signing of cooperation agreement with National Bank of Croatia, etc.
- October 2003: There were 46 participants in a Training Seminar held in Banja Luka. This included participants from both banking agencies, deposit insurance and CBBH.
- November 2003: Advisors Wilson and Taber attended the Coordination Meeting for Bank Supervision at CBBH.

***I-c. Develop supervisory tools through policies, procedures and training to ensure more effective supervision of banks and their subsidiaries/affiliates.***

### **Training:**

**Note:** Training will consist of a mix of seminars/workshops, on-the-job training (OJT), and other methods to complement their learning effort, build consistency and balanced for greatest effectiveness and efficiency. The project will likely not achieve all proposed training items, but will adjust scheduling and resource commitment in response to Agency priorities in recognition of changing needs and staff availability. Additionally, some of the proposed training will be covered through guided self-study, other providers and external sources. Agency staff will be included as (apprentice) instructors as appropriate to build internal capacity. Seminar and workshop related reference materials will be prepared in English & local languages.

- 1) *"Overall Conclusions and Bank Ratings"*. Revise text and case studies to current and projected banking situation in BiH to emphasize the changing risks, additional considerations for developing conclusions and ratings. Include "ownership" issues, potential impact positive and negative. Contrast different performance results between banks in same market and causes of difference. Use Analysis Form implemented in Off-site training in 2002. Emphasize forms and methods that can improve efficiency. Introduce corporate and bond ratings by Rating Services (Moody's, Fitch, S&P) and uses/impact.  
>June-03, for all BS staff, and representatives of DIA & CBBH.
- 2) Provide OJT/workshop in Analysis for Off-site determinations of Bank Ratings coupled with Targeted Onsite examinations. Build on training in 2002 and to complement training above.  
>June-03, for Off-site and newer Onsite staff, and reps. DIA & CBBH.
- 3) Provide training on the potential impacts of affiliates/subsidiaries on bank and need to consider the risk as part of effective supervision. Introduce by examples in case studies used in *"Overall Conclusions and Bank Ratings"* in June-03. Provide more specific training at later seminar/workshop, likely combined with related training issues.  
>TBD\_\_\_\_\_.
- 4) Locate outside seminars for limited number of staff to attend to increase their specialty training; provide support for sharing such knowledge by internal briefing of associates. Example: Bank Supervisors Central and Eastern Europe, Basel/Toronto Centre, National Bank of Poland, etc. >Ongoing.
- 5) Accounting issues/International Accounting Standards (IAS), especially on mergers, goodwill and acquisition expenses. Ongoing as issues surface, brief workshops in conjunction with Offsite Analysis training and by outside seminars. OJT follow-up pertaining to most relevant standards, case study approach with examples brought by participants, focus on application of standards and key issues within each, and inadequate implemented standards in banking system.  
>June-03, ongoing, ad hoc, include with other training efforts.
- 6) Fundamentals seminar(s) - Courses (previously developed and presented) for newer examiners: proposed subjects include accounting, credit, liquidity, internal control and internal/ external audit, and repeat of *"Ethics & Professional Conduct"*. Recognizing that newer staff members have some field experience, combine introduction and intermediate courses in most instances. Include agencies staff as participating instructors on repeat courses.  
>Q4-03 through Q2-04 depending on staff availability and other priorities.
- 7) On-site examinations manual. Drafts are partially completed. BA-RS has numerous recommendations from use in examinations. FBA has used partially but not developed specific list of recommendations. TDY with interaction with supervisory personnel could substantially complete. Advisors will emphasize need for a joint working group of examiners to complete and get approval.  
>Q4-03 and Q1-04.

**Measurable Goals:**

- Most training topics listed will be achieved through a mix of methods.
- Onsite Examination Procedures based on CAMELS will be in use for guidance or reference.
- Project will provide training and reference materials that bank supervision can use in continuing its learning and development efforts, including study guides and contacts with external education sources.

**Achievement:****Significant Progress made:**

- April 2003: BSP assisted FBA prepare and deliver four days of training to another government agency (FOSS) on financial crime, money laundering and investigations in banks. Six FBA officials/examiners participated as instructors with facilitation by the Senior Project Associate. After presenting the legal framework, theory and description of problem, they presented case studies to illustrate how to investigate and document. The training of others also helps FBA develop internal training capacity and confidence.
- June 2003: BSP delivered the Training Workshop “*Overall Conclusions and Bank Ratings*”. It was modified from the course delivered January 2000 to increase emphasis on: management evaluation, contrast of management systems, bank failure versus satisfactory performance and causes, ownership issues, changes and new products, accounting issues and an introduction to ratings by Rating Services (Moody's, Fitch, S&P). Numerous case studies and handouts were developed to support or reinforce the training. Participants included: BA-RS (13), FBA (14) and DIA (3). Advisors Mohler, Taber and Wilson were lead instructors, and FBA Examiner Kotoric presented Bank Ratings based on CAMELS and the agency regulation on bank ratings. Most participants made presentations of their case study group conclusions.
- June 2003: TDY Advisor provided guidance to Off-site Analysts in using their procedures efficiently to develop bank ratings.
- October 2003: BSP delivered a training seminar: “Financial Instruments and Markets: New Products and Associated Risks” to 46 persons from the two Banking Agencies, the Deposit Insurance Agency and CBBH. This included emerging issues requested by the Agencies. Some banks have had activity in potentially high-risk financial instruments and more are expected to follow. The Agenda addressed current issues and introduced likely new market instruments with emphasis on methods for evaluating banks’ risk management.

Lead instructor Mohler worked with Agency personnel in the design of the workshop and delivered much of the material. TDY instructor, Susan Ballinger, who has extensive experience in capital and money markets in major commercial banks and in emerging market countries, assisted and delivered an important block on foreign exchange (FX). Advisor Taber also assisted on several subjects including subordinated debt and present value models. He presented the participants with an automated model for computing present value estimates. A senior RS Banking Agency examiner presented an important case study, based on an actual supervisory situation that stimulated much discussion.

- BSP assisted Officials and Examiners prepare for several external seminars: e.g., Basle II – Capital Accords, Consolidated Supervision, Crisis Management and Advanced Credit Analysis.
- BSP translated documents to assist the officials and staff with better understand of important topics, e.g., selected papers on “*Basle II – Capital Accords*”, “*Building an Effective Framework for Bank Supervision - Prudential Regulation and Banking Supervision*”, *Executive Summary of USAID Report on “Micro-Credit Organization and Savings Mobilization”*. Some documents were shared with CBBH.

***I-d. Strengthen the supervisory capacity of senior management and field supervisors to provide for a safe and sound financial sector in Bosnia by anticipating challenges, especially in new markets, products and risk areas.***

### **Training:**

- 1) Provide seminar on new products in general and determining and managing risks. Include presentations on specific new products expected and how to evaluate risk.
- 2) Case study and/or workshop presentations by professional staff of examples they have found. (Note: 8 RS banks have established Investment Departments with no apparent institutional capacity.)  
 >Plan Q4-03 through Q2-04 and ongoing search for external seminars.
- 3) “*Securities, Managing Investments Risk*”(new). All professional staff. Key focus on banks’ likely role in market and potential risks. This subject also relates to consolidated supervision issues. Securities Commission professional staff should be invited to help with mutual understanding of roles and issues. Further development of the action plan and timing on this area is needed.  
 >Project early 2004 (Q1-Q2).
- 4) Locate outside seminars on new products, investments and associated risks for limited number of staff to attend, develop specialist roles and to be resource to others on return. Development of specialist skills should be in addition to general examiner competency that must be maintained by rotation of assignments and full training.  
 >Ongoing effort.

### **Achievement:**

- June 2003: Advisor Mohler followed up with reinforcement discussions with Off-site management personnel and developed agendas for proposed workshops in critical accounting and financial issues that concern the banking agencies. One was delivered in October 2003 as noted above. The other is planned for Q1-04.

### **Human Resources:**

- 1) Restart joint-working group on Examiner Evaluations, Examiner Training and Development, and Accreditation for Examiners. Coordinate in conjunction with developing Human Resources and a Performance Management process within consolidated bank supervision in CBBH or state level agency.  
 >Q3-03 through Q2-04, in coordination with consolidation.

- 2) Assist in establishment and training for the “Development Office” to build research, detection and identification capabilities for new risks and threats, develop counter-measures to manage risks and develop staff expertise to meet the changing challenges. This includes managing internal training and development of supervisory staff competencies to meet the challenges. *(Action Plan for this area needs to be developed in conjunction with next item above in consolidation. A proposed statement of duties and responsibilities has been drafted.)*
- 3) Provide additional training to Senior Project Associate in this area, focus more of her time on managing the Human Resources and Training initiatives and assisting with the overall effort in this area.  
>Begin Q2-03.
- 4) Associate will develop and implement a process for managing the training and development of new supervision staff. This process will be designed to build into the overall development and training process leading to Examiner Accreditation *(and Analyst Certification)*. This process will be developed as an integral part of bank supervision with the ability to link into future development of Human Resources function.  
>Initiate Q2-03, Ongoing.

#### **Measurable Goals:**

- Processes for Examiner Accreditation and Performance Evaluation will be in operation that builds a culture of professional development and institution building.
- New “Development Office” will be established or in the process of establishment.
- A Training and Development Process for new examiners will be initiated that can be sustained and built upon.

#### **Achievement:**

No measurable achievement thus far.

- A proposed statement of duties and responsibilities for a “Research and Development Office” has been drafted. The FBA’s Managing Board has approved a position but it may not be filled until the decision is made on structure of agency consolidation.

***I-e. Develop an improved ‘early warning’ capability that better integrates various indicators of a bank’s condition so that the banking agency can address potential issues earlier.***

- 1) Work with appropriate parties to develop a strategic plan for a consolidated database that is shared by Bank Supervision, Deposit Insurance Agency and CBBH. *(Need Expert to evaluate present database capabilities, make recommendations and initiate a Steering Group in developing the plan. Involve: Representatives of 2 Agencies, CBBH, DIA & IT from each, Expert. This is a part of the attached Action Plan on Consolidation. )*  
>Estimate beginning September 2003.
- 2) Work with appropriate parties to reduce the number of separate forms submitted by banks and to ensure that the needed information is received. *(This will involve reviewing the need and uses of forms, the frequency of reporting, consolidating some*



*forms and eliminating others. Involve: 2 Agencies, CBBH, DIA and 2-3 representatives of commercial banks via Bankers Assoc. See attachment.)*

>Begin Q1-04.

- 3) Off-site analysis. Joint training in off-site workshop, to ensure compatibility and accord in standards of analysis; with IT, development of more sophisticated tools and more automated MIS, including such features as edit checks and other comparable populations for peer comparison. *(See Attached Action Plan.)*

>Include in June-03 and (..?..) in conjunction with consolidation.

### **Measurable Goals:**

- Databases will be consolidated and operating.
- Early Warning System will be improved and more efficient.
- Offsite Analysis will be more effective in surveillance and risk management, and provide more efficiency in scheduling and prioritizing the use of human resources.

### **Achievement:**

No measurable achievement at this point, however:

- June & September 2003: Advisor Mohler implemented a plan for reviewing the bank reports and initiating changes to harmonize the reports between agencies, reduce duplications, streamline reporting, improve compliance with IAS, etc. before consolidation of the database. Comments on Common Database under I-a apply.

***I-f. Expand the banking agencies abilities to other related financial sectors. Three such sectors are insurance, investment banking and investment or money management funds. As banks expand into other lines of business, the banking agencies will need to keep abreast of these developments, and to build up in-house expertise to identify the kinds of risks that these lines of business can cause depositors.***

- 1) Provide training on Bank Investments as part of Funds Management and Liquidity. Include information and training on Market Risks, including price, FX, Interest Rate Risk, Swaps & Forwards, etc. >Plan Q4-03 or Q1-04.
- 2) Provide training on investment management by banks for clients (securities trading, management of PIFs, brokerages, brokerage, stock exchange, risk management issues, etc.). Include use of applicable ratings (Moody's, Fitch, S&P) >Plan Q4-03 or Q1-04.
- 3) Locate outside seminars on targeted issues above. >Ongoing effort. (also Securities training proposed under Training section)

### **Measurable Goals: (combine f. & g.)**

***I-g. Develop supervisory capacity to recognize and identify the inherent risk (capital, asset quality, earnings, liquidity, risk management and internal controls) at the consolidated level, as well as individual subsidiaries and/or affiliates level.***

**Training:**

- 1) Present training on recognizing risks in consolidated and subsidiary/affiliate relationships, as noted above in I-c-3.
- 2) Locate external seminars as noted above. >Ongoing effort.

**Measurable Goals (f. & g.):**

- Bank Supervision will have regulation and/or procedures implemented in this area.
- Bank Supervision will have more technical knowledge and risk management competence in these new and changing areas, and will demonstrate by addressing issues promptly.
- Regulation or Procedures will be developed to provide guidance to supervision.
- Communication avenues will be established with other regulators to enhance cooperation and joint efforts.

**Achievement:****Partial:**

- Advisors have discussed these issues with counterparts and project actions in 4Q-03 and early 2004 regarding Consolidated Supervision and relationships with other regulators.
- June 2003: Advisor Wilson and Project Manager Bittner met with the Head of Insurance Supervision in the Federation. He indicated that an inadequate law existed, that state level law and supervision were needed, more staff expertise needed, etc. *[Subsequent note: A new state level law is reportedly under review in government committee.]*
- June 2003: As noted in I-d above, Advisors Mohler and Taber developed a general outline for training in financial, capital market issues for delivery later.
- October 2003: "I-f" Training delivered as noted above under I-c.
- November 2003: TDY Attorney Gegenheimer provided recommended changes to the law to provide better legal authority for Consolidated Supervision. This will be held by BSP until the Law on Banks is to be amended (estimated first half of 2004). He also provided a major paper on Consolidated Supervision Experiences in several countries that is being prepared for Law Journal publication.

**II. REGULATIONS**

***Recommend regulatory changes to facilitate improved bank supervision. As supervisory activities expand, current regulations will need to be revised and enhanced, and new regulations created to incorporate the necessary components for an effective and efficient legal, regulatory and judicial framework.***

- 1) Review laws, regulations, practices, etc. to include amendments when the laws/regulations are being amended for consolidation of bank supervision. Monitor and anticipate problems occurring involving laws, regulations and procedures and develop an ongoing list of such changes needed.  
>Ongoing - effort with agencies, CBBH.

- 2) Review laws, regulations, practices, etc. in view of new products/services, subsidiaries, ownership structures, etc. that may impact the ability to supervise effectively, or may obstruct needed new products and changes.  
 >Ongoing effort as such issues are anticipated or arise.

### **Measurable Goals:**

- Evaluation will be performed of changes needed, and guidance on priority issues will be provided on laws, regulations and practices during consolidation changes.
- Enhancements will be made to laws, regulations or procedures in these areas.

### **Achievement:**

#### **Partial.**

- September 2003: BSP provided information for an IMF Mission reviewing the effectiveness of banking supervision, laws and regulations, conformance to EU Directives, etc. Their review should provide additional recommendations for enhancements.
- November 2003: As noted above, Attorney Gegenheimer reviewed the Law on Banks and provided recommendations for changes regarding Consolidated Supervision.

## **III. LEGAL FRAMEWORK**

***III-a. Improve the legal protection for bank agency staff (management and supervisors) so they are not at risk of personal liability when carrying out their official functions.***

### **Achievement:**

#### **Partial.**

- July 2003: Advisor had several meetings with OHR attorneys to develop a position and opinion regarding legal protection and immunity that was forwarded to the Prosecutor's Office.
- Advisor met with several representatives of organizations, including OHR and CBBH Governor to discuss ongoing threats against FBA and its officials.
- Advisor assisted OHR in activities resulting in OHR providing a "Legal Opinion" to Prosecutors and Court in one case, and providing "Court Monitors" in two cases.
- Advisor provided OHR attorneys with copies of: excerpts from Basle Bank Committee's "Core Principles for Effective Bank Supervision", a World Bank Study in 1999 on Legal Protection in twenty countries and papers developed by an attorney experienced in this area.
- October 2003: Advisor Wilson and TDY Attorney Gegenheimer met with OHR attorney to discuss this matter and need to maintain appropriate protection against improper charges and personal risk. OHR had indicated an interest in reviewing the wording of "Legal Protection clauses" in various laws, including the Central Bank and Banking Agencies.

**III-b. *Influence the courts to demonstrate appropriate judicial deference to the expertise of the banking supervisor as is common in most western economies.***

Project will find and focus on certain technical matters within its expertise and work with OHR/others to include in their contact and education of police, prosecutors and courts.

**NOTE:** Scope of this item could be very broad, outside our control and difficult to attain.  
Possibility: locate attorney/judicial expert with related experience to work joint with OHR sponsored seminar for judges, prosecutors, investigating police, et al.  
Estimate: Combine timing with Legal work on Consolidation, Q3-4 2003.

**Measurable Goals: (a. & b.):**

- Provide training and reference materials to prosecutors and judges.
- Provide training at University of Law/Criminology (future benefits).

**Achievement:**

**Partial.**

- Advisor Wilson made a presentation on the “*Role and Responsibilities of Bank Supervisors*” at two seminars on “*Financial Crime and the new Criminal Code Procedures*” for judges, prosecutors, police, tax investigators, etc.

See also III-a above for actions.

**III-c. *Work on regulatory changes, on an as needed basis, that might involve non-bank financial institutions, e.g., micro-finance organizations or savings and loan institutions.***

- 1) Review legislation (law and regulations), developing practices and areas of population under-served in current financial environment.  
➤ Ongoing efforts as initiatives develop.
- 2) Cooperate with USAID FSBAT project, World Bank Local Initiatives Project, MOF, et al, on changes in laws, regulations for non-bank financial operations, such as Micro-finance evolves and savings/credit are considered.  
➤ Ongoing efforts as initiatives develop.

**Measurable Goals:**

- Provide support and recommendations to appropriate groups.

**Achievement:**

**Partial.**

- Advisor met with FSBAT and Local Initiatives Project representatives to discuss pertinent laws and actions planned.
- Advisor discussed an upcoming seminar in Basle on Micro-Finance with FBA Deputy Director that he and the Director of Local Initiatives Project will attend. A key seminar topic is “Supervision of MFOs”.

- BSP translated the Executive Summary of USAID Report on “*Micro-Credit Organization and Savings Mobilization*” to assist agency officials and others better understand its findings.

#### **IV. INTEGRATED SUPERVISION**

**NOTE:** *Tasks listed here relate more to consolidation of banking supervision than to normal meaning of integration of supervision of non-bank financial activities.*

*See also actions planned under Institutional Development section.*

***IV-a. Encourage and facilitate cooperation and integration of functions, to the greatest extent possible, between the RS and Federation banking agencies.***

- 1) Propose a joint agency examination team to examine a bank in each entity. The objective will be to enhance cooperation in supervision objectives, harmonize supervision approach, procedures, developing conclusions and ratings process.  
>Q2-3-03.
- 2) Propose joint agency AML targeted examinations.  
>Q2-3-03.

**Measurable Goals:**

- Evidence of joint efforts in bank supervision, training and development of processes.

**Achievement:**

**Partial.**

- BSP assisted on harmonizing of bank regulatory reporting.
- BSP provided joint training.
- BSP provided Examination Procedures Manuals.

***IV-b. Work with the Central Bank to better integrate the bank supervision functions between both entities, possibly creating one combined agency at the state level.***

Included in I-a. Consolidation.

**Measurable Goals:**

- Bank supervision operating as one supervision unit (*as above*).

**Achievement:**

No measurable achievement at this point, however see actions as noted in I-a above.

**V. DEPOSIT INSURANCE****V-a. *Encourage and facilitate cooperation between the bank supervision agencies and the BiH Deposit Insurance Agency.***

- 1) Actively participate in working group to update Agreement on Cooperation between bank supervision agencies and BiH DIA (*agency at state level*). Obtain full support and cooperation of key officials.  
>Begin Mar-03, complete Jun-03.
- 2) Participate in the development of procedures in regard to an Insurance Event, Payout and Recovery, and ensure the execution needs are included in the Agreement on Cooperation. (See comment below on Resolution and Payout function.)  
>Begin Mar-03, complete Jun-03.
- 3) Assist in development of compatible IT and unified database (see attached Action Plan on consolidation).

**Measurable Goals:**

- Evidence of cooperation or joint training between supervision and insurance.
- Joint development of needed payout procedures and recovery process.
- Shared database of bank reported financial data will be implemented.

**Achievement:****Partial.**

- June 2003: Modified Agreement on Cooperation ratified.
- June 2003: The three Directors appointed a Working Group (from 2 banking agencies, DIA and USAID, UST and GTZ advisors) to develop recommendations for cooperation and actions regarding the August 2003 deadline on mandatory requirement to qualify for deposit insurance.
- July 2003: The Working Group presented recommendations that were accepted and ratified. This included a Memorandum of Understanding to ensure fair and consistent actions, and a new DIA Regulation on post-deadline policy and procedure.
- BSP provided payout procedures excerpted from Provisional Administrator and Liquidator Manuals to DIA. Working group formed on payout procedures and resolution/recovery process. BSP plans a TDY Expert to review and make recommendations in 2004, including training.
- July-August: As noted in I-b above; brief diagnostic reviews of IT databases were performed. This provides a base for an in-depth analysis and design by FSVC volunteers in October 2003 followed by implementation actions by World Learning in 2004. Progress is being made on Common Database.

**V-b. Strengthen the links and capacities of the Bank Supervision Agencies, the Central Bank and the Deposit Insurance Agency. Ultimately, this may lead to the integration of all or some of these functions into one unit.**

- 1) Continue active participation in Coordination Meetings.
- 2) Participate in Technical Working Group on Consolidation and initiate actions described in Action Plan on Consolidation (and in this SOW).

**Measurable Goals:** *(see other consolidation items, especially I-a).*

**V-c. Strengthen the capacity of the Deposit Insurance Agency to protect the Insurance Fund and ensure the maximum recovery of funds paid out for insured deposits.**

- 1) Resolution and payout function –  
Provide copies of procedures developed for payouts during Provisional Administration and Bank Resolution. Work with Banking Agencies, Deposit Insurance Agency and Central Bank to develop organizational structure, authorities, processes, and internal controls to ensure that the significant experience and expertise of the Banking Agencies is retained and utilized, and that the interests of the Deposit Insurance Agency, including integrity of the deposit insurance fund, are protected. Recommended vehicle is a working group (with project advisors as members) for development of necessary policies and procedures for cooperation and payout during an Insurance Event.
- 2) Utilize TDY Expert to review Payout Procedures in existing Manual of banking agencies and adapt for effective and efficient use by DIA. Expert would also review the Provisional Administration and Liquidation process by banking agencies for appropriate involvement of DIA to protect their interests in recovery of any funds paid out. Expert would initiate or participate in necessary training to prepare DIA for such eventuality.  
>Initiate Mar-03, provide training as any uninsured pay-out event occurs- a possibility in 3Q-03.
- 3) Participate with representatives of bank supervision and deposit insurance to develop a process for monitoring of Provisional Administration and participation in Liquidation when there is a risk of an Insurance Event or an Insured Payout has occurred.
- 4) Assist the bank supervision agencies develop training-OJT in an uninsured bank in Provisional Administration or Liquidation to illustrate the process above to DIA.
- 5) Include DIA professional or analytical staff in technical training seminars/workshops as appropriate.

**Measurable Goals:**

- DIA has effective procedures to prepare for and execute a payout event.
- DIA has adequate understanding of Provisional Administration and Liquidation to participate in the process, protect its funds and effect maximum recovery.
- DIA participates in selected supervision training.

**Achievement:**

- As noted above, BSP has provided payout procedures. And, BSP plans for TDY Expert to review, recommend and train later in 2003 (delayed to 2004 as adequate time exists before any payout need).
- DIA staff invited to the Workshops in June and October 2003.

**VI. PROBLEM BANKS**
**VI-A. Facilitate the timely and effective resolution/liquidation of problem institutions, particularly ones taken over by the banking agencies.**

- 1) Review practices and discuss ways to overcome obstacles and increase the efficiency of bank resolution. Document “lessons learned” for use by these and other CEE bank supervision units.
- 2) Close-in advisor support “ad hoc” and as requested on interventions in process or anticipated.  
**Note:** Hercegovacka Bank in Provisional Administration may be transferred to FBA in 2003. Advisors will assist FBA develop a Strategy and Action Plan to deal with this unusual problem. (*Subsequent Note: Transfer did not happen.*)  
**Note:** BA-RS may need assistance in Q3 or Q4-03 (Deposit Ins. Requirement)

**Measurable Goals:**

- Advisors assist BA-RS on problem banks, enforcement and implementation of bank resolution, including Provisional Administration & Liquidation Procedures.
- Bank Supervision will have the competence to manage problem banks, intervention and resolution without support (end of contract period).

**Achievement:****Substantial.**

- June 2003: RS Resident Advisor and two TDY Advisors assisted officials of BA-RS plan and takeover a bank having serious liquidity problems. Advisors provided close technical support during the takeover of five principal offices and numerous sub-branches on the same day and worked through the weekend to secure all inventory. The bank was affected by its primary owner being intervened by OHR in Bosnia and his subsequent arrest by Serbian officials. Advisors also assisted by advising on the Provisional Administration and preparation of a “Bid Information Package”.
- August 2003: Advisor advised the Provisional Administrator of a Federation bank prepare a preliminary “*Bid Information Package*”.
- August & December 2003: Advisor reviewed and advised FBA on the proposal by the Federation government to combine the six un-privatized commercial banks into one bank under a plan to restructure through an action similar to the recent “*Sarajevo Privatization Venture*.” Four of the banks are under Provisional Administration. A new law to facilitate this is being drafted.
- October 2003: TDY Advisor Biggs assisted the Provisional Administrator of Hercegovacka Bank prepare and initiate tender offers on the bank, subsidiaries and an



asset taken in lieu of debts. This also included meetings with FBA officials to discuss and agree on certain actions.

**VI-b. Ongoing refinement of the legal/regulatory framework to ensure the banking agencies and Deposit Insurance Agency have appropriate authority in problem bank resolution and liquidation.**

- 1) Review obstacles and practices to determine needed changes in legal/regulatory framework to improve efficiency of bank resolution.

**Measurable Goals:** (as above).

## **VII. ANTI-MONEY LAUNDERING and COMBATING THE FINANCING OF TERRORISM**

**Implement the recommendations of the anti-money laundering working group and assist the agency in combating money laundering as the sector and agency evolve.**

- 1) Convene the AML Working Group on Banking Sector and update the status of issues and Recommendations. Include a representative of Office of High Representative (OHR) to participate, hopefully as Chair, to ensure participation of all representative parties. Determine needed actions and engage the appropriate parties.  
>Initiate actions in May 2003, complete status review of recommendations and develop new recommendations and initiatives to improve the effectiveness of AML / CBT efforts.
- 2) Participate in and support training in Financial Crimes, Anti-Money Laundering and Combating the Financing of Terrorism.  
>Apr-03 and ongoing.
- 3) Actively participate in efforts to further these objectives in legal framework, regulations, cooperative agreements, examination procedures and practice. Determine status of Law on AML – CFT circulated in 2002 and work to get implemented.  
>Re-start effort in Apr-03, and ongoing.

### **Measurable Goals:**

- Working Group addresses prior Recommendations and acts to improve AML & CFT compliance results.
- Bank Supervision process includes initiatives to improve compliance within their authorities and assist others to develop higher overall compliance.

### **Achievement:**

#### **Substantial.**

- April 2003: As noted under training, Associate Tuzovic advised and facilitated FBA in developing and presenting training to 35 members of the Federation Intelligence and Security Agency (FOSS) on investigation of financial crime in banks, money laundering and terrorism financing. Advisor Wilson commented on international efforts, cross-border issues, communication and cooperation.

- May 2003: Advisor Wilson and Associate Tuzovic obtained a commitment from a Senior Legal Official of Office of High Representative (OHR) to provide a Chairperson for the Working Group. A meeting was held with two officials in May to plan continuation of the Working Group. A letter was later sent to Working Group members requesting that they review the Recommendations previously published in booklet form, determine their status and respond. Additional representatives were invited to join the Working Group (State level Ministries of Security and Treasury, and Representatives of Bankers' Association in Federation and RS).
- July 2003: A Working Group meeting reviewed key issues and assigned tasks for members to perform regarding the Recommendations and New Issues. This included developing Actions Plans on each issue.
- July & August 2003: Advisor Wilson and Associate Tuzovic had several meetings with an OHR Official and Assistant to discuss aspects of the Working Group initiatives and plan additional actions to maintain progress on the Action Plans.
- August 2003: A Working Group meeting reviewed status of the Action Plans and planned additional actions. Advisor Taber and Associate Tuzovic provided research and support for the meeting.
- Advisor Taber met with US-DOJ/ICITAP Expert to review a proposal under development in Republika Srpska regarding a company registration process to prevent the fictitious shell company problem in money laundering.
- September – October 2003: Advisor and Associate met with OHR officials several times on a larger OHR Action Plan being developed based on the Working Group's Action Plan for the Banking Sector.
- November 2003: BSP Associate Tuzovic and IT Specialist Siljak met with representatives of OHR, U.S. Embassy and ICITEP to discuss potential for automated software and other technology issues being implemented in banks through FBA IT infrastructure. They also met with representatives of the Spanish Development Agency regarding the potential of using Bank of Spain software. (*The Spanish government will support the establishment of an FIU.*) An FSVC volunteer participated in three of the meetings.
- November 2003: Associate Tuzovic and the Head of AML – CFT at FBA attended a seminar in Riga, Latvia on “New Developments and Technology in Anti-Money Laundering”.
- November 2003: Advisor Wilson attended a Seminar with FBA officials at OHR on the OHR Action Plan developed based largely on the Action Plan developed by the Working Group noted above.

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**NOTE:** Given the dynamic nature of the Bosnian banking sector, and the Bosnian political environment in general, USAID reserves the right to conduct a reassessment and clarification of the project's goals to more accurately reflect the changing environment over the period of the contract.